(5)

Supreme Court, U.S.
FILED
AUG 29 1994
CLERK

No. 93-1974

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

ROGER W. TRACY,
TAX COMMISSIONER OF OHIO,
Petitioner,

v.

MCI TELECOMMUNICATIONS CORPORATION,
Respondent.

REPLY BRIEF ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF OHIO

LEE FISHER
Ohio Attorney General

JAMES C. SAUER
(Counsel of Record)
BARTON A. HUBBARD
Assistant Attorneys General
RICHARD A. CORDRAY
State Solicitor
SIMON B. KARAS
Deputy Chief Counsel
30 East Broad Street, 16th Floor
Columbus, Ohio 43215-3428
(614) 466-5967

COUNSEL FOR PETITIONER

TABLE OF CONTENTS

Page

REPLY BRIEF 1

CONCLUSION 10

TABLE OF AUTHORITIES

Cases **Page**

Allied Stores of Ohio, Inc. v. Bowers,
358 U.S. 522 (1959) 6, 8

American Sugar Refining Co. v. Louisiana,
179 U.S. 89 (1900) 4

Boston Real Estate Bd. v. Department of Pub. Utils.,
136 N.E.2d 243 (Mass. 1956) 5

Bosworth v. Pledger, 810 S.W.2d 918 (Ark.),
cert. denied, 112 S. Ct. 617 (1991) 6, 8

C. Thomas Stores Sales System v. Spaeth,
297 N.W. 9 (Minn. 1941) 6, 8

Capitol Cablevision Corp. v. Hardesty,
285 S.E.2d 412 (W.Va. 1981) 7

Charleston Fed. Savings & Loan Ass'n v. Alderson,
324 U.S. 182 (1945) 3, 8

Chesterfield Cablevision v. County of Chesterfield,
401 S.E.2d 678 (Va. 1991) 7

GTE Sprint Communications Corp. v. Wisconsin Bell, Inc., 454 N.W.2d 797 (Wis.1990) 7

Nordlinger v. Hahn, 112 S. Ct. 2326 (1992) 6, 8

TABLE OF AUTHORITIES (cont'd.)

Cases **Page**

Pacific Express Co. v. Siebert,
142 U.S. 339 (1892) 3, 4, 5

Snowden v. Hughes, 321 U.S. 1 (1943) 9

State ex rel. Utils. Comm'n v. Southern Bell Tel. & Tel. Co., 363 S.E.2d 73 (N.C. App. 1987) 2, 6

No. 93-1974

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

ROGER W. TRACY,
TAX COMMISSIONER OF OHIO,
Petitioner,
v.
MCI TELECOMMUNICATIONS CORPORATION,
Respondent.

REPLY BRIEF ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF OHIO

Petitioner, the Tax Commissioner of Ohio, submits this reply brief in order to address several points raised in Respondent's Brief in Opposition, as follows:

1. Respondent initially seeks to dismiss the importance of this appeal by misstating the critical issue here. Respondent suggests that this case involves the imposition of different taxes on essentially the same business entities. *See* Resp. 1-2, 5-6, 9-12. This suggestion is neither factually correct nor accurate as a description of the central issue before this Court. Instead, the issue here is whether it is constitutional for the State of Ohio to tax telephone companies that are "facility-based carriers" in a distinct category from mere "resellers" of telecommunications services. *See* Pet. 4-5, 14-16.

Respondent is a "facility-based carrier," which is engaged in the business of transmitting long-distance telephonic messages by operation of its own integrated system of transmission equipment, circuits, and switches. Respondent thus holds and uses substantial property within the State of Ohio in order to provide the service to its customers of sending such messages across intervening space from a point of origination to a point of termination. Pet. A-54 to A-56. Respondent and all other facility-based carriers thus sell this service either directly to the public or to a "reseller." A "reseller" acts as a simple middleman, which sells to the public without itself performing any service and, significantly, without owning or operating any system of transmission equipment or holding and using any such property within the State.[1] The "middleman" nature of mere resellers has been distinguished from the distinct business conducted by facility-based carriers in Ohio, *see id.*, and elsewhere. *See, State ex rel. Utils. Comm'n. v. Southern Bell Tel. & Tel. Co.*, 363 S.E. 2d 73, 78 (N.C. App. 1987) (recognizing the distinction, as well as the continually changing nature of the developing telecommunications industry).

---

[1] Contrary to Respondent's suggestion, *see* Resp. 2, any property held and used by a reseller is fundamentally different from the extensive property held and used by a facility-based carrier. Resellers do not own, lease, operate, or pay tax on an integrated system of transmission equipment, which is precisely what qualifies a facility-based carrier as a "telephone company" subject to the public utility property tax. *See* Pet. A-54 to A-56. Although resellers may operate some minor pieces of switching equipment in accessing the transmission network of a facility-based carrier, such equipment is at most an incidental part of the "actual transmission facilities" held and used by a telephone company. *Id.* A-35 to A-36.

2. The authority of the States to exercise their essential taxing power by basing legitimate tax classifications on these substantial business differences between a "reseller" and a "facility-based carrier" is the true issue in this appeal. In its decision below, the Ohio Supreme Court held that a company which produces the product or performs the service it sells (*e.g.*, a "facility-based carrier") may not be classified separately from a company whose business is limited to buying and reselling such product or service (*e.g.*, "resellers"). Pet. A-12.[2] That holding is in error, and Respondent does not effectively negate this Court's established line of cases holding that this precise tax classification does *not* violate the Equal Protection Clause.

This Court has long held that the Equal Protection Clause does not prohibit differential taxation of companies that perform or provide a service directly to the public, as opposed to mere resellers of any such service.

As early as *Pacific Express Co. v. Siebert*, 142 U.S. 339 (1892), this Court rejected an equal protection challenge to a tax statute that distinguished between railroad and

---

[2] Respondent's contention that the Ohio Supreme Court's ruling was based on the fact that two facility-based carriers (Allnet and Cable & Wireless) had avoided assessment as telephone companies, even though they may have been similarly situated as to Respondent, *see* Resp. 6, 14-15, is a pure smoke screen. Any such avoidance of tax was due to those companies' apparent failure to file proper returns as telephone companies and a possible error in the audit of the general property tax returns that they did file. *See* R. 278. The irrelevance of this point is shown, however, by the fact that even the Ohio Supreme Court did not view this possible error as reflective of any intentional or systematic discrimination. *Cf. Charleston Fed. Savings & Loan Ass'n v. Alderson*, 324 U.S. 182 (1945) (same).

steamboat companies, which performed transportation services for sale to the public, and express companies, which acted as mere resellers by purchasing such transportation services from the railroad and steamboat companies for resale to their own customers. This Court approved the tax classification applied by the State to distinguish between those two lines of business, holding that "[t]heir different nature, character, and means of doing business justify the discrimination in this respect which the legislature has seen fit to impose." *Id.* at 354. The constitutional validity of such tax classification has thus been well established for decades. *See also, American Sugar Refining Co. v. Louisiana*, 179 U.S. 89 (1900) (Equal Protection Clause is not violated by a state statute that imposed a license tax on middlemen who bought sugar to refine for sale to the public, but exempted persons who produced the sugar which they refined and sold).

Respondent's discussion of these cases acknowledges the force of the principle this Court applied. It concedes that the middlemen and producers in question were engaged in "wholly different" businesses. Resp. 13. Respondent attempts to ignore this principle, however, by focusing on irrelevant incidentals of each such classification, suggesting, for example, that this case has nothing to do with railroads or sugar production. *Id.* Respondent is finally content simply to assert that the present case does not involve different businesses. This assertion directly contradicts Respondent's admission that the middlemen and producers in question in *Pacific Express* and *American Sugar* were engaged in "wholly different" businesses. Moreover, this assertion fails to explain why the well established principle of constitutional law, which concededly allows States to distinguish for tax purposes between middlemen and

producers, should be ignored.

In fact, this principle cannot and should not be so casually cast aside, for this Court has explicitly held that it is constitutionally permissible for States to recognize the "essential difference" between mere resellers and "other companies that own their own means of" producing the service in question. *Siebert*, 142 U.S. at 353. That is the exact distinction that the State of Ohio has employed for purposes of the *ad valorem* property tax, to distinguish between resellers of long-distance telecommunications services and facility-based carriers who provide such service.

3. The decision below is thus out of step with this Court's longstanding precedents applying the Equal Protection Clause to such state tax classifications. It also conflicts with decisions which other state courts have rendered. Contrary to Respondent's characterization of such cases as inapplicable, *see* Resp. 13 n.12, courts in other states have repeatedly recognized that the distinction between the producer or performer of a good or service and one who merely buys and resells the good or service is a valid basis for the State to classify the businesses differently for purposes of taxation. *See* Pet. 19-22 (discussing cases). Without reiterating this discussion from the Petition, it is significant that Respondent acknowledges that various state courts have upheld the constitutionality of tax classifications based on this distinction. Respondent's purported answer, however, is to again point to other peripheral, and legally irrelevant, distinctions between the cases, such as that the Massachusetts Supreme Court's decision involved electrical services and the Minnesota Supreme Court's decision involved chain store merchants. Resp. 13 n.12 (citing *Boston Real Estate Bd. v. Department of Pub. Utils.*, 136

N.E.2d 243 (Mass. 1956), and *C. Thomas Stores Sales System v. Spaeth*, 297 N.W. 9 (Minn. 1941)). Again, such trivial "distinctions" are without legal significance and have no force to sweep aside the longstanding principles of constitutional law the state courts have applied in following this Court's own controlling decisions.

In addition, Respondent does not satisfactorily elude the consequences of more recent decisions such as *Bosworth v. Pledger*, 810 S.W.2d 918 (Ark.), *cert. denied*, 112 S. Ct. 617 (1991), and *State ex rel. Utils. Comm'n v. Southern Bell Tel. & Tel. Co.*, 363 S.E.2d 73 (N.C. App. 1987), by disregarding the purposes for which these cases were relied upon by Petitioner. Indeed, Respondent has completely avoided the point of the citations. Namely, the Arkansas Supreme Court's properly deferential approach to an equal protection challenge to a state tax classification of telephone services in *Bosworth* could not more starkly contrast with the erroneous approach adopted by the Ohio Supreme Court below in this case. *See, e.g., id.* at 922 (noting "wide latitude" afforded to States in upholding a tax classification between "WATS" line services and other long distance telephone transmission services where "there is any conceivable set of facts to uphold the law's rational basis"). The two approaches are frankly irreconcilable, and only *Bosworth* can be squared with this Court's precedents. *See, e.g., Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522 (1959); *Nordlinger v. Hahn*, 112 S. Ct. 2326 (1992).

Moreover, *Southern Bell* expressly recognizes that "facility operating companies" and "resellers" represent different "categories" of the larger class of interexchange companies, each with its own "distinctive characteristics." 363 S.E.2d at 78. The *Southern Bell* court's recognition of

these fundamental differences refutes Respondent's repeated assertion that the two kinds of businesses are one and the same -- the sole basis on which Respondent has sought to distinguish the settled case law upholding distinctions between producers and resellers for state tax purposes. *See also, Chesterfield Cablevision v. County of Chesterfield*, 401 S.E.2d 678 (Va. 1991) (recognizing and upholding against equal protection challenge the distinction drawn between broadcast stations, which produce programs themselves and broadcast them to the public, and cable television companies, which simply receive and retransmit such broadcasts to the public); *Capitol Cablevision Corp. v. Hardesty*, 285 S.E.2d 412, 420 (W.Va. 1981)(same)[3].

4. The basic error that pervades the decision below, and that renders it in conflict with this Court's decisions and those of other state courts, is the Ohio Supreme Court's refusal to defer to a rational legislative tax classification and, in particular, its refusal even to consider several rational bases that were put forward to support this tax classification. Those justifications -- chief among which is the time-honored distinction between producers and resellers -- have already been noted. *See* Pet. 14-16.

---

[3] Respondent's contention, *see* Resp. 14, that *GTE Sprint Communications Corp. v. Wisconsin Bell, Inc.*, 454 N.W.2d 797 (Wis. 1990), is consistent with this Court's equal protection analysis is plainly erroneous. Not only is that case inapplicable because it involved a different tax (sales) with a different object (transactions), it failed even to attempt to inquire whether any conceivable basis existed for distinguishing between "facility-based carriers" and "resellers." The case, therefore, underscores the breadth of the problem facing States in the taxation of the telecommunications industry and the need for this Court to reiterate the well-established principle of wide deference to legitimate legislative tax classifications in this area also.

Respondent's lone counter is to claim that these justifications are not adequately supported by the record, Resp. 11-12. The record refutes such claim and this would have become evident had the Ohio Supreme Court made the necessary inquiry. Its failure to undertake this inquiry was an even more fundamental error, for under this Court's decisions, the proper judicial approach to state tax classifications is to determine whether *any conceivable rational basis exists* to support the classification. *See, e.g., Allied Stores*, 358 U.S. at 526-29; *Nordlinger*, 112 S. Ct. at 2332-34; *Bosworth*, 810 S.W.2d at 922. No such analysis occurred here.

Instead, the court below was apparently persuaded that, because this tax classification differed from the state's treatment of such entities for the manifestly distinct purposes of public utility regulation under the State's separate police power, it should therefore be presumed invalid. *See* Pet. 6-7. Such a rationale completely misapplies the applicable precedents under the Equal Protection Clause. *See, e.g., Charleston Federal Savings & Loan Ass'n v. Alderson*, 324 U.S. 182, 191 (1945); *C. Thomas Stores*, 297 N.W. at 18.

This misapplication of constitutional law was compounded by the court's willingness merely to assume that resellers existed that owned property within the State of Ohio and that had been treated differently from Respondent. Pet. 16-18. On the contrary, the only fact cited by Respondent in support of its allegation of actual discriminatory treatment was that two facility-based carriers -- Allnet and Cable & Wireless -- had apparently filed incorrect returns that had not been detected in the audits performed to date. The possibility of such administrative error, which was candidly acknowledged by the Tax Commissioner, R. 278, constitutes

the sole basis for Respondent's core claim that it was being taxed at a 100% rate while similarly situated companies were being taxed at a 31% rate. It is clear, however, that any such unequal application of the tax statutes would not deny equal protection of the laws, unless an intentional or invidious discrimination were shown, *see, e.g., Snowden v. Hughes*, 321 U.S. 1, 8 (1943). None was shown or found in this case.

5. In conclusion, Petitioner again urges the Court to recognize the critical nature of this issue both to the State of Ohio and to the essential taxing power of all state governments. In this particular case, it is estimated that more than $200,000,000 in taxes and interest will have to be refunded if this decision is allowed to stand. Most of these refunds would come directly from the budgets of Ohio's public schools. *See* Pet. 9 n.2. The decision below also is certain to have ramifications that go well beyond the State's ability to classify taxpayers within the telecommunications industry. As described above, the principles at issue here directly affect not only all regulated industries, but all industries that include distinct producers and resellers. The Ohio Supreme Court's decision thus threatens to establish a precedent that would severely inhibit the legitimate exercise of legislative discretion to draw rational tax classifications.

Perhaps most significant is the intractable problem of federalism created by the decision below. The Ohio Supreme Court has rendered a decision that disables the state taxing authority as a matter of federal constitutional law. Unless this Court intervenes by granting a writ of certiorari, that discordant interpretation of the Equal Protection Clause will be cemented as a lasting limitation on Ohio's ability to fund services through such tax classifications. The state

government has available no means of redress other than this opportunity for appeal to this Court.

CONCLUSION

For these reasons, as well as those presented at more length in the initial petition, the Ohio Tax Commissioner respectfully requests that the petition for a writ of certiorari be granted in this case to review the decision of the Ohio Supreme Court.

Respectfully submitted,

LEE FISHER
Ohio Attorney General

JAMES C. SAUER
(Counsel of Record)
BARTON A. HUBBARD
Assistant Attorneys General
RICHARD A. CORDRAY
State Solicitor
SIMON B. KARAS
Deputy Chief Counsel
30 East Broad Street, 16th Floor
Columbus, Ohio 43215-3428
(614) 466-5967

COUNSEL FOR PETITIONER